STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions :

of :

ACCESSORIES BY PEARL, INC. : DETERMINATION

for Redetermination of Deficiencies or for Refunds of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended June 30, 1981, 1982, 1983 and 1984. :

Petitioner, Accessories by Pearl, Inc., 330 Fifth Avenue, New York, New York 10001, filed petitions for redetermination of deficiencies or for refunds of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended June 30, 1981, 1982, 1983 and 1984 (File Nos. 801583 and 803554).

A hearing was held before Joseph W. Pinto, Jr., Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on May 4, 1987 at 1:15 P.M., with all briefs to be filed by September 14, 1987. Petitioner appeared by Siegel, Mendlowitz & Rich, P.C. (Randy Blaustein, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether petitioner is entitled to an additional investment tax credit in the fiscal years ended June 30, 1981 and 1982 pursuant to Tax Law § 210.12-A for property acquired during the fiscal years ended June 30, 1978 and 1979, despite petitioner's failure to apply for the investment tax credit in the years of acquisition.

II. Whether the Audit Division properly recomputed entire net income by excluding the expense deduction from the Federal and State depreciation figures for the fiscal year ended June 30, 1983.

III. Whether the Audit Division properly disallowed certain investment tax credits taken by petitioner on items which were deemed not used directly in the production of goods for the fiscal years ended June 30, 1983 and 1984.

FINDINGS OF FACT

1. On June 29, 1984, pursuant to a desk audit performed by the Audit Division, a Statement of Audit Adjustment was issued to petitioner, Accessories by Pearl, Inc. (hereinafter "Accessories"), which stated a tax deficiency for the fiscal year ended June 30, 1981 of $2,470.00 and interest of $1,085.59, fora total balance due of $3,555.59. Said statement also included the following explanation:

"Tax on allocated net income per report	$4,830.00
Less adjusted investment tax credit	278.00
Tax due	4,552.00
Tax per report	2,082.00
Deficiency	2,470.00

Since no forms CT-46 (claim for investment tax credit) were filed and no investment tax credit was claimed on your New York State franchise tax reports for the periods ended 6/30/78 and 6/30/79, no additional credit may be claimed for those years. Additional credit claimed in the amounts of $61.00 (6/30/78) and $2,425.00 (6/30/79) is disallowed. Total additional credit allowed is $88.00 from period ended 6/30/80.

As of 6/1/81, investment tax credit was increased to 5% of qualified property. Therefore, property acquired 6/81, totaling $1,524.00, has investment tax credit of $76.00 instead of $60.00, an increase of $16.00. Investment tax credit of $174.00, plus increase of $16.00, results in an investment tax credit of $190.00.

Investment tax credit of $190.00 plus additional credit of $88.00 results in a total of $278.00."

2. On June 29, 1984, the Audit Division issued a Statement of Audit Adjustment to petitioner for the fiscal year ended June 30, 1982 setting forth a tax deficiency of $3,419.00 and interest of $549.00, for a total balance due of $3,968.69. Said statement also included an explanation which stated as follows:

"Federal Taxable income per report	$116,101.00
Plus interest to stockholder less $1,000.00	4,750.00
Plus New York State franchise tax deducted on federal return	7,986.00
Adjusted entire net income	128,837.00
Allocated @ 57.725%	74,371.00
Tax @ 10%	7,437.00
Less adjusted investment tax credit	1,517.00
Tax due	5,920.00
Tax per report	2,501.00
Deficiency	3,419.00

Based on information submitted in your representative's correspondence dated June 4, 1984, interest to stockholders amounted to $5,750.00 less $1,000.00 deduction, or $4,750.00.

Per Section 210.12 of the New York State Corporation Tax Law, the alarm, typewriter, time clock and magnetic board do not qualify for investment tax credit since they are not principally used in the production of goods. Therefore, cost of qualified property has been reduced to $26,682.00 ($34,360.00 property claimed less $7,678.00 disallowed equals $26,682.00 of qualified property). Also, investment tax credit on qualified property was at the rate of 5% from 6/1/81 through 6/30/82. Qualified property for $26,682.00 at 5% is $1,334.00.

Based on the explanation in the statement of audit adjustment for period ended

6/30/81, additional investment tax credit for $2,425.00 is disallowed.

Also, per statement of audit adjustment for 6/30/81, investment tax credit for 6/30/81 was increased to $190.00. Additional credit allowed is 50% or $95.00. Total additional investment tax credit is $88.00 plus $95.00 or $183.00. Total investment tax credit is $1,334.00 plus $183.00 or $1,517.00."

3. On March 28, 1986, the Audit Division issued to Accessories a Statement of Audit Adjustment which set forth a tax deficiency of $969.00 and interest of $325.75, for a total balance due of $1,294.75 for the fiscal year ended June 30, 1983. Said statement also included the following explanation:

"Federal taxable income, Schedule B Line 17	$102,502.00
Interest to stockholders ($6,080.00 - $1,000.00)	5,080.00
New York franchise tax	(999.00)
Adjusted ACRS deduction	33,531.00
Adjusted total additions	140,114.00
Less: Adjusted New York depreciation	37,772.00
Investment tax credit adjustment	380.00
Adjusted entire net income	101,962.00
Allocated @ 54.6925%	55,766.00
Tax @ 10%	5,577.00
Adjusted investment tax credit allowed	1,688.00
Adjusted tax due	3,889.00
Tax per report	2,920.00
Deficiency	969.00

Entire net income has been recomputed to exclude the expense deduction of $5,000.00 from the ACRS and the New York depreciation figures.

For federal tax purposes a taxpayer who elects to expense part of the cost of the qualifying property under IRC Section 179, must reduce the property's basis in an amount equal to the expense deduction. In addition, federal requirements (IRS Section 167(g)) which state that property placed in service after December 31, 1982, must reduce the cost by 50% of the investment tax credit.

The basis for computing New York depreciation and investment tax credit is the federal reduced basis, in accordance with Regulation Section 5-2.4(d)(e).

Your claim for investment tax credit, for the wall brackets for fans and the fans, has been disallowed as these items are deemed as not being used directly in the production of goods. Regulation Section 5-2.4(b).

The following adjustments have been made to your claim for investment tax credit to reflect the above:

Total property claimed	$24,184.00
Less: Expensed amount	5,000.00
Investment tax credit adjustment	222.00*
Disallowed property	5,000.00

Total property allowed		13,962.00
Rate in effect	X 6%	
Investment tax credit allowed for this period		$ 838.00**

*$9,433.00 - $5,000.00 = $4,433.00 X 10% X 50% = $222.00

The amount of additional investment tax credit allowed for this period is $850.00. The following schedule reflects previous adjustments of 6/29/84:

Period First Claimed	Allowed Original ITC	Additional Allowed This Period
6/30/80	$ 176.00	$ 88.00
6/30/81	190.00	95.00
6/30/82	1,334.00	667.00
Total		$ 850.00**

** Total investment tax credit allowed: $ 838.00
850.00
$1,688.00"

4. On March 28, 1986, the Audit Division issued to Accessories a Statement of Audit Adjustment for the fiscal year ended June 30, 1984 which set forth a tax deficiency of $728.00 and interest of $139.48, for a total balance due of $867.48. Said statement also included the following explanation:

"Tax on allocated net income	$4,804.00
Adjusted investment tax credit allowed	2,394.00
Adjusted tax due	2,410.00
Tax per CT-3	1,682.00
Deficiency	728.00

Your investment tax credit claimed for this period has been adjusted as follows:

Total property claimed		$21,284.00
Less investment tax credit adjustment		1,064.00*
Total property allowed		20,220.00
Rate in effect	X 6%	
Investment tax credit allowed for this period		$ 1,213.00**

*Cost reduced by 50% federal investment tax credit (see assessment #C860328100N) $21,284.00 X 10% X 50% = $1,064.00

Additional investment tax credit has been allowed as follows:

Period First Claimed	Allowed Original ITC	Additional Allowed This Period
6/30/81	$ 190.00	$ 95.00
6/30/82	1,334.00	667.00
6/30/83	838.00	419.00
Total		$1,181.00**

**Total investment allowed:	$ 1,213.00
	1,181.00
	$ 2,394.00"

5. On March 28, 1986, the Audit Division issued a Statement of Audit Adjustment to Accessories for the fiscal year ended June 30, 1983 which set forth a tax deficiency of $174.00 and interest of $58.50, for a total balance due of $232.50. The explanation set forth on the statement indicated that the Metropolitan Transportation Business Tax Surcharge in effect during the period had been increased as the result of an increase in the tax for the fiscal year ended June 30, 1983. The computation was set forth as follows:

"Adjusted tax due	$3,889.00
Metropolitan Transportation Business Tax Surcharge @ 18%	700.00
Metropolitan Transportation Business Tax Surcharge per CT-3M	526.00
Additional Metropolitan Transportation Business Tax Surcharge due	174.00"

6. On March 28, 1986, the Audit Division issued a Statement of Audit Adjustment to Accessories for the fiscal year ended June 30, 1984 which set forth a tax deficiency of $124.00 and interest of $23.75, for a total balance due of $147.75. The statement included an explanation that the Metropolitan Transportation Business Tax Surcharge had been increased as the result of an increase in tax for the fiscal year ended June 30, 1984. The computation of said increased surcharge was set forth as follows:

"Adjusted tax due	$2,410.00
Metropolitan Transportation Business Tax Surcharge @ 17%	410.00
Metropolitan Transportation Business Tax Surcharge per CT-3M	286.00
Additional Metropolitan Transportation Business Tax Surcharge due	124.00"

7. On September 12, 1984, the Audit Division issued two notices of deficiency to Accessories for the fiscal years ended June 30, 1981 and 1982. Said deficiencies set forth the following information:

Period Ended	Additional Tax Due or Tax Deficiencies	Interest	Balance Due
6/30/81	$2,470.00	$1,177.83	$3,647.83
6/30/82	3,419.00	652.65	4,071.65

8. On May 13, 1986, the Audit Division issued two notices of deficiency to Accessories for the fiscal years ended June 30, 1983 and June 30, 1984 which set forth the additional tax due, interest and balance due as follows:

Period Ended	Additional Tax Due or Tax Deficiencies	Interest	Balance Due
6/30/83	$969.00	$341.34	$1,310.34
6/30/84	728.00	149.93	877.93

9. On May 2, 1986, the Audit Division issued to Assessories two notices of deficiency for the fiscal years ended June 30, 1983 and 1984 representing the increase in the Metropolitan Transportation Business Tax Surcharge which resulted from an increase in the tax due for said years. The notices set forth the following information:

Period Ended	Additional Tax Due or Tax Deficiencies	Interest	Balance Due
6/30/83	$174.00	$60.63	$234.63
6/30/84	124.00	25.10	149.10

10. Accessories filed timely corporation franchise tax reports for the fiscal years ended June 30, 1978, 1979, 1981 and 1982. Petitioner did not file claims for investment tax credit with those reports filed for the fiscal years ended June 30, 1978 and 1979. However, claims for additional investment tax credit for property acquired during fiscal years ended June 30, 1978 and 1979 were filed with the reports for fiscal years ended June 30, 1981 and 1982.

11. On April 18, 1984, the Audit Division sent a letter to petitioner with regard to the New York State franchise tax reports filed for the fiscal years ended June 30, 1980, 1981 and 1982. The letter requested more information with regard to the claims for investment tax credit, asking for a detailed description of the property claimed. The Audit Division also asked petitioner to submit a schedule disclosing to whom interest expense was paid, the amount paid to each lender and said lenders' relationship to petitioner and its stockholders.

12. On September 20, 1984, petitioner, by its representatives, Siegel, Mendlowitz, & Rich, P.C., filed with the Audit Division forms CT-46, Claim for Investment Tax Credit, for the fiscal years ended June 30, 1978 and 1979. For the period ended June 30, 1978, petitioner claimed a net investment tax credit of $122.00 on machinery used to produce belts which machinery was acquired on December 30, 1977 and June 30, 1978. For the fiscal year ended June 30, 1979, petitioner claimed a net investment tax credit of $4,849.00 on machinery used to produce belts which machinery was acquired on December 31, 1978 and June 30, 1979.

13. Petitioner filed claims for investment tax credit for the periods ended June 30, 1981 and June 30, 1982 with its corporation franchise tax reports for those respective years. On schedule C of each CT-46, Claim for Investment Tax Credit, petitioner claimed the additional investment tax credits for the fiscal years ended June 30, 1978 and 1979. For the fiscal year ended June 30, 1981, petitioner claimed that $122.00 was the amount of the original investment tax credit granted in the fiscal year ended June 30, 1978 and that an additional investment tax credit of $61.00 was claimed for the fiscal year ended June 30, 1981. For the fiscal year ended June 30, 1982, petitioner claimed an original investment tax credit for the fiscal year ended June 30, 1979 of $4,849.00 and an additional investment tax credit of $2,425.00 for the fiscal year ended June 30, 1982. These two claims for additional investment tax credit were made despite the fact that no investment tax credit had been granted or applied for with respect to the fiscal years ended June 30, 1978 or June 30, 1979.

14. In response to the Audit Division's April 18, 1984 letter requesting further information with regard to the investment property and interest expense, the taxpayer provided a list of property for which the investment tax credit was claimed, including a factory alarm system, a typewriter used in inventory control, a time clock used in the factory and a magnetic board used in production control. The Audit Division denied the investment tax credit on said items. Further, the schedule of interest claimed for the fiscal year ended June 30, 1982 included an amount in the sum of $5,750.00 paid to P. Degenshein, who was described as an employee of the corporation and a parent of one of the stockholders. The Audit Division added back this amount less $1,000 to entire net income.

15. From a New York State Department of Labor form entitled Employer's Report of Contributions with respect to Accessories by Pearl, Inc. for the period July 1, 1981 through June 30, 1984, it was determined that the average number of employees of Accessories by Pearl, Inc. was as follows:

Period	Average Number of Employees
7/1/81-6/30/82	174.5
7/1/82-6/30/83	190
7/1/83-6/30/84	195.75

16. For the fiscal years ended June 30, 1983 and 1984 petitioner timely filed corporation franchise tax reports. Petitioner also filed Forms CT-3M, Metropolitan Business Tax Surcharge Reports, for the same periods, in a timely fashion. Petitioner filed claims for investment tax credit, for the fiscal years ended June 30, 1983 and 1984 which included wall brackets for fans and 40 fans acquired in August of 1982 for the sum of $5,000.00. The Audit Division determined that these items were not used directly in the production of goods and therefore disallowed them.

17. Petitioner is a New York corporation engaged in the business of manufacturing women's belts.

SUMMARY OF PETITIONER'S POSITION

18. With regard to the fiscal years ended June 30, 1981 and June 30, 1982, petitioner claims that an oversight by its prior accountant resulted in investment tax credits not being applied for in the fiscal years ended June 30, 1978 and 1979. Petitioner contends that it would have been entitled to investment tax credits had it applied for them. In fact, the Audit Division concedes that said property would have been eligible for the investment tax credit. The taxpayer further contends that it is entitled to the New York State additional investment tax credit based upon the increase in the number of its employees. The taxpayer also makes the argument that nowhere in the Tax Law does it state that a taxpayer must claim an original investment tax credit in order to qualify for the additional investment tax credit.

19. With regard to the fiscal years ended June 30, 1983 and 1984, the taxpayer argues that the Audit Division incorrectly disallowed deductions and/or investment tax credits.

CONCLUSIONS OF LAW

A. With regard to the fiscal years ended June 30, 1981 and June 30, 1982, there are two issues: Whether petitioner is entitled to an additional investment tax credit for the fiscal years ended June 30, 1978 and 1979 where no credit was claimed on the franchise tax reports for those periods; and whether or not certain items of property qualified for the investment tax credit for the period ended June 30, 1982.

1. Petitioner filed claims for investment tax credit, for property acquired during fiscal years ended June 30, 1978 and 1979 on September 20, 1984. The claims attached to the reports filed for the fiscal years ended June 30, 1981 and 1982 included claims for investment tax credit for the fiscal years ended June 30, 1981 and 1982 and also a claim for the additional investment tax credit for the fiscal years ended June 30, 1978, 1979, 1980 and 1981 pursuant to Tax Law § 210.12-A.

A Claim for Credit or Refund of Corporation Franchise Tax must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever is later (Tax Law § 1087[a], [e]; New York Stock Exchange, Inc., State Tax Commission, September 28, 1983). Therefore, the claims for investment tax credit filed in 1984 for the fiscal years ended June 30, 1978 and 1979 were not timely and are denied.

Since petitioner's claims for investment tax credit for the fiscal years ended June 30, 1978 and 1979 were properly denied by the Audit Division, petitioner is not entitled to the additional investment tax credits which it claimed on the reports filed for the fiscal years ended June 30, 1981 and 1982. Tax Law § 210.12-A states that:

> "Where a taxpayer is allowed a credit under subdivision twelve, with respect to property, the acquisition, construction, reconstruction or erection of which commenced on or after the first day of January, nineteen hundred seventy-six, the taxpayer shall be allowed a credit for each of the three years next succeeding the taxable year for which the credit under subdivision twelve is allowed with respect to such property...."

The critical language in said section is "where a taxpayer is allowed a credit". Since petitioner herein was not allowed an investment tax credit for the fiscal years ended June 30, 1978 and 1979, it is not entitled to the additional tax credits for those years. It is of no consequence that petitioner might have been eligible for the credit had it applied for same. Having failed to qualify for the investment tax credit, petitioner was not entitled to the additional investment tax credit (General Mills Restaurant Group, Inc. v. Chu, 125 AD2d 762).

2. With regard to the fiscal year ended June 30, 1982, it is noteworthy that petitioner did not contest the Audit Division's finding that certain equipment, viz., the alarm, typewriter, time clock and magnetic board, did not qualify for an investment tax credit since it was not principally used in the production of goods. It should be borne in mind that in any case in the Division of Tax Appeals under this article, the burden of proof is upon the petitioner (Tax Law § 1089[e]). Since it did not contest the Audit Division's finding, it has not carried its burden of proof.

Tax Law § 210.12(b) provides an investment tax credit to corporations with respect to tangible personal property which is depreciable pursuant to section 167 of the Internal Revenue Code, has a useful life of four years or longer, is acquired by purchase as defined in section 179(d) of the Code, has a situs in New York and is "principally used by the taxpayer in the production of goods by manufacturing, processing, assembling...." The term manufacturing is defined in said section as the process of working raw materials into wares suitable for use or which gives new shapes, new quality or new combinations to matter which already has gone through some artificial process by the use of machinery, tools, appliances and other similar equipment. Given the definition, and petitioner's failure to contest the Audit Division's finding, the Audit Division was correct in disallowing the investment tax credit claimed by petitioner for the alarm, typewriter, time clock and magnetic board.

The adjustments made by the Audit Division embodied in the statements of audit adjustment issued on June 29, 1984 covering the fiscal years ended June 30, 1981 and 1982 were proper and the notices of deficiency which embodied said adjustments for said periods are sustained.

B. With regard to the fiscal years ended June 30, 1983 and 1984, the issues involved the recomputation of entire net income, excluding the expense deduction from the Federal and New York depreciation figures. Since petitioner had taken an expense deduction of $5,000.00 on the same machinery for which it elected to apply for an investment tax credit, it must reduce the property's basis in an amount equal to the expense deduction (see Internal Revenue Code § 1016[a]). Additionally, the Internal Revenue Code ("IRC") provides that where a credit is determined under IRC § 46(a) with respect to IRC § 38 property, the basis of such property shall be reduced by 50 percent of the amount of the credit so determined (IRC § 48[q]). Since the New York Tax Law defers to the Internal Revenue Code for its definitions of "cost" and "other basis", the provisions set forth in the Internal Revenue Code govern this situation (see 20 NYCRR § 5-2.4[d], [e]).

Therefore, the explanation set forth on the Statement of Audit Adjustment for the fiscal year ended June 30, 1983 was correct with regard to the exclusion of the expense deduction of $5,000.00 and the reduction in cost by 50 percent of the investment tax credit taken for Federal purposes.

In light of the statutory requirements set forth in Tax Law § 210.12(b) above, and the regulations at 20 NYCRR § 5-2.4(a), (b) and (c), the 40 fans and wall brackets do not qualify for the investment tax credit pursuant to New York Tax Law. Therefore, the $5,000.00 claimed for said items was properly excluded by the Audit Division in the recomputation of the investment tax credit.

For the fiscal year ended June 30, 1984, the recomputation performed by the Audit Division on the Statement of Audit Adjustment dated March 28, 1986 was proper in that the investment tax credit adjustment was determined by reducing the cost by 50 percent of the Federal investment tax credit.

It should also be noted that the additional investment tax credit was allowed on the revised Investment Tax Credit figures for the fiscal years ended June 30, 1983 and 1984.

C. The Audit Division's adjustment of the Metropolitan Transportation Business Tax Surcharge for the fiscal years ended June 30, 1983 and 1984 was proper since there was a proper increase in the tax liability for petitioner for both periods. The computation was in accordance with Tax Law § 209-B which states that for the privilege of exercising its corporate franchise in the metropolitan commuter transportation district the taxpayer shall pay, in addition to the tax imposed under Tax Law § 209, a tax computed at the rate of 18 percent of the tax imposed under such section 209 for the taxable years ending before December 31, 1983 and at a rate of 17 percent of the tax imposed for taxable years ending on or after December 31, 1983.

D. The petitions of Accessories by Pearl, Inc. are hereby denied and the notices of deficiency issued on September 12, 1984 for the fiscal years ended June 30, 1981 and 1982, the notices of deficiency issued on May 2, 1986 for the fiscal years ended June 30, 1983 and 1984 and the notices of deficiency issued on May 13, 1986 for the fiscal years ended June 30, 1983 and 1984 are sustained.

DATED: Albany, New York
May 5, 1988

/s/
ADMINISTRATIVE LAW JUDGE